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SUBJECT: TREASURY SECRETARY PUSHES CAPITAL MARKET REFORM  
WITH CSRC CHAIRMAN SHANG FULIN

#### SUMMARY

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[1](#)1. (SBU) Summary: In an August 1 meeting with Treasury Secretary Paulson, China Securities Regulatory Commission

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(CSRC) Chairman Shang Fulin described steps CSRC has taken to implement SED agreements, including licensing foreign stock market rep offices, resuming licensing new securities firms, increasing the quota for qualified foreign institutional investors (QFII) and expanding the scope of business for foreign joint venture securities companies. In particular, lifting the moratorium on licensing of new securities firms may occur as soon as September, three months earlier than committed. Shang also said joint venture securities companies could receive licenses to offer a full range of services by the end of the year. Secretary Paulson suggested China allow 100% foreign-owned securities companies to compete in China and encouraged Shang to allow wholly-owned affiliates of international credit ratings agencies to rate RMB denominated bonds. Shang responded that China needs to evaluate the progress of the current two pilot JVs, Goldman Sachs-Gao Hua and UBS-Beijing Securities, before adjusting equity caps. He welcomed the suggestion to allow international ratings agencies to rate RMB debt, but noted that domestic ratings agencies would resist. End Summary.

#### ENVIRONMENTAL FACTORS AFFECT STOCK MARKET LISTING DECISIONS

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[1](#)2. (SBU) Secretary Paulson described the Chinese conservation efforts he observed during his visit to Qinghai Lake. Shang noted that environmental performance is one of the indicators CSRC considers in its review of applications for listing on China's stock markets.

#### CSRC Report Card on SED II Deliverables

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[1](#)3. (SBU) Shang reported on progress in implementing SED commitments to date:

a) NYSE and NASDAQ Rep Offices: applications received, expect review and approval by October;

b) Moratorium on Licenses for Securities Companies: aim to resume issuing in September, three months ahead of the SED

commitment;

c) Qualified Foreign Institutional Investor (QFII) Quota: CSRC now coordinating with other agencies (mainly the State Administration for Foreign Exchange, SAFE), but expects to increase quota from USD 10 to 30 billion by the end of 2007 (Comment: SED commitment is to do so before SED III. Even after the overall quota is increased, it will take time to issue firm specific quotas. Embassy sources note that SAFE, which is concerned about excessive capital inflows, is delaying implementation. End comment);

d) Scope of Business for Foreign JV Securities Companies: working to issue new regulations so JV,s could have a full securities license (i.e. be able to undertake brokerage and proprietary trading) by the end of 2007. (Comment: This is more forward leaning than SED commitment to announce before SED III that JV securities will be able to expand gradually their scope of business).

#### Equity Caps

14. (SBU) Secretary Paulson said it is hard to find cases of ownership caps on greenfield securities investments in major developing economies like Mexico, India and Russia. Secretary Paulson said that ownership caps should not be

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confused with market structure or development; the regulator decides on new product approvals and the "rules of the game." The best policy, he said, is to allow the world's best firms to come in, compete and train local talent. He noted that some domestic players may not welcome the competition, but reminded Shang that those interests may not be in line with national interests.

15. (SBU) Citing the Goldman Sachs-Gao Hua and UBS-Beijing Securities joint venture (JV) deals, Shang said China needs

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to first review the results of these pilot JVs before adjusting equity caps.

16. (SBU) Shang said China attaches great importance to opening the securities sector, but this must be gradual and conducive to stable economic development. Despite the Chinese stock market's rise over the past two years, he explained that many problems still exist. He believed movements in China's stock market had little influence on global financial markets.

#### Let International Ratings Agencies Rate RMB Debt

17. (SBU) Secretary Paulson praised CSRC's efforts to develop its bond market. He suggested that China allow international credit ratings agencies to rate China RMB denominated debt as a way to promote the domestic bond market. (Comment: Currently, only JVs in which foreign firms are limited to a 49 percent stake can rate RMB denominated bonds in China). Shang welcomed the suggestion. He explained that bond scandals in the early 90's resulted in strict regulations that required that listed bonds have bank guarantees, which eliminated the need for ratings. However, CSRC now has authority over bond issuance and will adopt a market-oriented approach. He said CSRC welcomes foreign credit ratings agencies, but pointed out that domestic ratings agencies will resist.

18. (U) Secretary Paulson's delegation cleared this cable.  
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